



## The KDM Dairy Report - May 28th, 2004

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### On the bright side:

- While they were down from the previous week, NASS averages for cheese came in higher than expected, with blocks at \$2.12, down 4.6¢, and barrels at \$2.05, down 7.7¢. Butter decreased 6.2¢ to average \$2.09, but NDM increased 0.4¢ to 84.4¢/lb and dry whey increased 0.8¢ to 30.7¢/lb.
- March Commercial Disappearance: Nonfat dry milk use increased 155.5% vs. a year ago, and 96% vs. February, according to USDA numbers released in the full Livestock, Dairy & Poultry Outlook report. Most of it was probably reconstituted and added to the vat. American cheese use was also higher, up 6.6% vs. the prior year, and Other cheese use was up 10.1% from a year ago.
- In the cash markets, barrels rose 16¢ on Monday, to close the spread with blocks to 3¢. Blocks finished the week unchanged at \$1.80 while barrels settled at \$1.77.
- 1st-cut hay is being delayed due to the constant rains experienced this past two weeks in the Midwest. Prices for Western-sourced hay are going up as a result.
- Economy: U.S. GDP (gross domestic product) grew at a healthy 4.4% pace for the 1st quarter, up from the 4.2% growth in the previous quarter.
- Economy: Consumer spending in April was up 0.3% while incomes rose 0.6%, the largest gain since January 2001. With income rising faster than spending, Americans' disposable income grew, which bodes well for both future spending and saving.
- Initiated by the Dairy Checkoff program, McDonalds will be rolling out 8-ounce "Milk Jugs" in new Happy Meals to more than 13,500 stores nationwide starting in June. In a pilot test, the new containers resulted in a 400% increase in McDonalds milk sales. The same success on a national basis could increase milk sales by more than 200 million pounds annually.
- CWT II ready to go. The 2004 version of CWT has signed on three more coops, including AMPI and Foremost Farms. The program has \$15-16 million left over from last year and all startup loans have been repaid.

Futures Month	Friday 05/28	Friday 05/21	Change	Avg Since 1995	Top 3rd Price	Top 5th Price
May-04	\$20.55	\$20.48	\$0.07	\$11.27	\$11.94	\$12.59
Jun-04	\$16.77	\$15.86	\$0.91	\$11.65	\$12.48	\$13.30
Jul-04	\$14.60	\$14.11	\$0.49	\$12.46	\$13.38	\$14.28
Aug-04	\$14.46	\$14.12	\$0.34	\$13.16	\$14.17	\$15.17
Sep-04	\$14.33	\$14.15	\$0.18	\$13.61	\$14.59	\$15.56
Oct-04	\$13.80	\$13.95	(\$0.15)	\$12.98	\$13.82	\$14.65
Nov-04	\$13.02	\$12.85	\$0.17	\$11.92	\$12.97	\$14.00
Dec-04	\$12.10	\$11.95	\$0.15	\$11.92	\$12.97	\$14.01
Jan-05	\$12.20	\$11.95	\$0.25	\$11.89	\$12.71	\$13.52
Feb-05	\$12.10	\$12.05	\$0.05	\$11.34	\$11.90	\$12.45
Mar-05	\$12.00	\$11.95	\$0.05	\$11.66	\$12.34	\$13.01
Apr-05	\$12.15	\$12.00	\$0.15	\$12.08	\$13.31	\$14.52
May-05	\$12.35	\$12.15	\$0.20	\$11.27	\$11.94	\$12.59
Jun-05	\$12.40	\$12.10	\$0.30	\$11.65	\$12.48	\$13.30
Jul-05	\$12.50	\$12.50	\$0.00	\$12.46	\$13.38	\$14.28
Aug-05	\$12.60	\$12.60	\$0.00	\$13.16	\$14.17	\$15.17
Sep-05	\$12.75	\$12.75	\$0.00	\$13.61	\$14.59	\$15.56

### however....

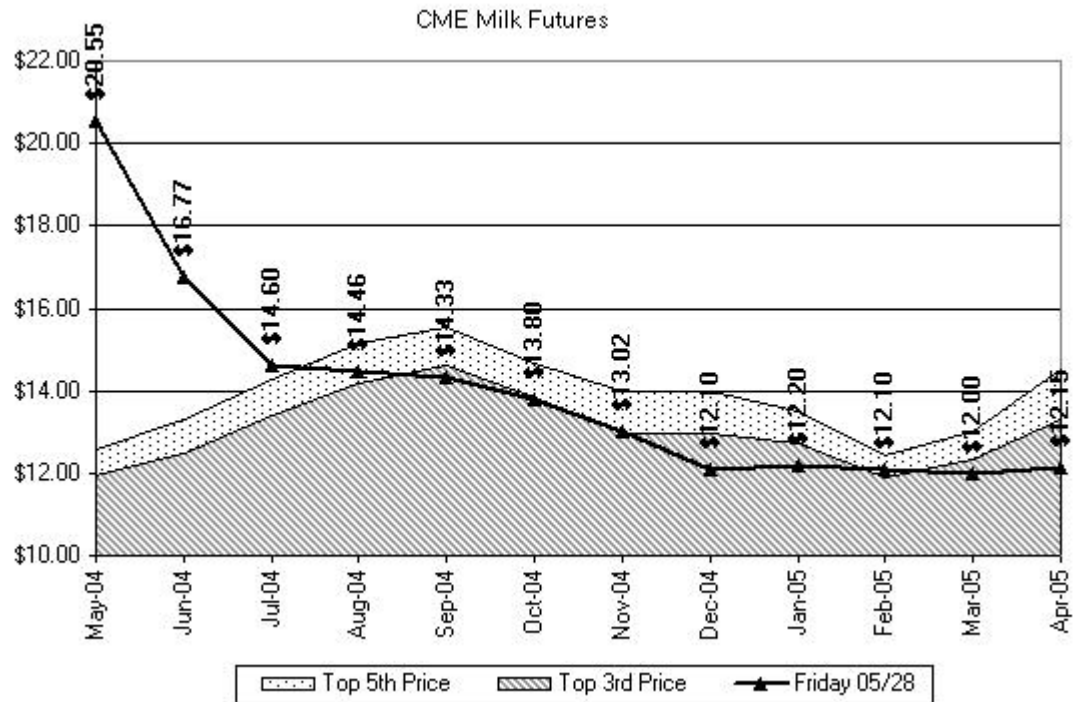
- Dairy cow slaughter for the week ending 05/15 was off 9,400 head vs. the prior year, an 18% decrease.
- Although cash cheese held its ground, buyers were forced to purchase 34 cars of blocks and 43 cars of barrels to support it. One car load is about 44,000 lbs, so nearly 3.4 million lbs of cheese exchanged hands this week.
- Cash butter fell 24.5¢ vs. a week ago, with 59 loads trading hands. With cheese production slowing, more milk has been available for the churn, putting pressure on prices.
- Fluid Milk & Cream Review writes that supplies are burdensome, and that, "...this Memorial Day holiday

may be one of the heaviest milk-processing weekends we've seen in the last four to five years."

- Ideal weather in May has California production 1-2% over year ago levels, according to Dairy Market News. An unusually cool May has production up in the Midwest as well.
- Demand for cheese, especially for the process market, is slow, according to Dairy Market News. "Bulk cheese sales remain sluggish and plant inventories continue to build."
- Churning activity is very heavy, with excess cream in the East being sent to Midwest butter producers. "The combination of spring flush, slowing Class I milk demand, and less milk clearing to Class III (cheese) plants is causing most butter/powder plants to operate at peak levels", reports Dairy Market News.
- Licensed cheese imports were up 45% in April, according to numbers released by the USDA.
- Economy: The consumer confidence index slipped 4 points in May, despite the improving labor market. Higher gasoline prices and the war in Iraq were primary areas of consumer worry.

### Recommendation:

Product has arrived. The 77 loads of cheese sold in the cash market this week may be a taste of things to come. With schools winding down, cheese plants limiting inventories and production at seasonal highs, the milk pipeline has backed up. As we move into June with a Class I price over \$21, more milk will be sent to the vat for production. Futures for July through September are already reflecting a lower cheese price of around \$1.60. We may be headed there, but the emotion of this market could see futures dropping lower than that if the barrel and block markets break.



With July through September recovering somewhat from last week's lows, our current recommendation is to sell futures in those months on whatever portion of your milk you feel comfortable. Then be prepared to buy calls, or buy back your futures positions at or near \$1.00 lower than your sell price. Summer weather may be a factor, and in central Texas, it is now humid and 90 degrees. If summer prices stall in the \$14 range, we may see a tremendous cull in June and July, as marginal animals that have been profitably milked up to now, no longer remain economical.

To discuss this and more advanced strategies, call us! 877.695.8538

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